

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:03

PLR-104999-21

Date:

September 01, 2021

### Legend

X =

Date 1 =

Date 2 =

Date 3 =

A =

B =

C =

Trust 1 =

Trust 2 =

Trust 3 =

Dear \_\_\_\_\_ :

This letter responds to a letter dated March 1, 2021, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

### Facts

The information submitted states that X elected to be treated as an S corporation effective Date 1. On Date 2, shares of X were transferred to each of Trust 1, Trust 2, and Trust 3 (collectively, the Trusts). Effective Date 2, A, B, and C (collectively, the Beneficiaries) made elections to treat Trust 1, Trust 2, and Trust 3, respectively, as qualified subchapter S trusts (QSSTs) within the meaning of 1361(d)(3). Despite the stated intent in each of the trust instruments for the Trusts to be QSSTs, the Trusts by their terms did not satisfy the qualifications under § 1361(d)(3). Thus, Trust 1, Trust 2, and Trust 3 were ineligible shareholders of X, causing X's S corporation election to terminate, effective Date 2.

X states that, effective Date 3, the trustees of Trust 1, Trust 2, and Trust 3, respectively, each requested under § 1.1361-1(j)(12) to convert Trust 1, Trust 2, and Trust 3 from QSSTs to electing small business trust (ESBT) under § 1361(e).

X represents that since Date 2, it has filed federal tax returns consistent with being an S corporation. X represents the termination of its S corporation election was inadvertent and was not motivated by a tax avoidance motive or retroactive tax planning. X further represents that A, B, and C reported their allocable share of Trust 1, Trust 2, and Trust 3's income, respectively, on all affected returns consistent with the treatment of the Trusts as QSSTs from Date 2 to Date 3. X represents that X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

### Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1362(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of section 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1361(d)(2) applies.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust; and (iv) upon termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(6)(ii) of the Income Taxation Regulations provides that the current income beneficiary of the trust must make the election by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under section 1362(a) by any corporation was terminated under section 1362(d)(2); (2) the Secretary determines that the circumstances resulting in termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to section 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

### Conclusion

Based solely on the facts submitted and the representations, we conclude that X's S corporation election terminated within the meaning of § 1362(f) on Date 2 when stock was transferred to Trust 1, Trust 2, and Trust 3, ineligible shareholders. We further conclude that the termination of X's S corporation election on Date 2 was inadvertent within the meaning of section 1362(f). Pursuant to the provisions of section

1362(f), X will be treated as continuing to be an S corporation from Date 2 and thereafter, provided that X's S corporation election is valid and not otherwise terminated under section 1362(d) for reasons not stated in this letter.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation or Trust 1, Trust 2, and Trust 3's eligibility to qualify as an ESBT.

This ruling is directed only to the taxpayer who requested it. According to section 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Adrienne M. Mikolashek  
Chief, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure:  
Copy for 6110 purposes

cc: